February 9, 2004

Is Highway Spending on a Collision Course With Deficits?

Executive Summary

- The five-month extension (P.L. 108-88) of the Transportation Equity Act for the 21st Century (TEA-21, P.L. 105-178), which authorizes contract and budget authority for all federal highway and mass transit programs, will expire on February 29, 2004.
- The Senate is now considering comprehensive, six-year reauthorization legislation The Safe, Accountable, Flexible and Efficient Transportation Equity Act of 2004 (SAFETEA), S. 1072.
- The SAFETEA bill contains a significant funding gap between the desired spending levels and anticipated transportation-related excise tax receipts. That gap must be closed by pursuing one or more of the following options:
 - Increase excise tax receipts either by increasing taxes on gasoline and other transportation funding sources, or by expanding the transportation excise tax base through elimination of exemptions and special tax treatments (or some combination thereof);
 - Use revenue raisers from non-transportation sources (i.e., general revenues) to finance the portion of the transportation authorization above excise tax receipts;
 - o Deficit-finance additional transportation spending; or
 - o Reduce the amount of contract authority authorized by the legislation.

The purpose of this paper is to examine arguments for and against these options. Note that the Senate Finance Committee's reported provisions follow a combination of options one and two. The Committee's proposals increase HTF receipts by eliminating exemptions and partially taxed motor fuels, charge the General Fund for the cost of these energy-production incentives, and use revenue raisers to offset the deficit impact. Other options or combinations thereof may be considered on the Senate floor.

Introduction

The five-month extension (P.L. 108-88) of the Transportation Equity Act for the 21st Century (TEA-21, P.L. 105-178), which authorizes contract and budget authority for all federal highway and mass transit programs, will expire on February 29, 2004. The Senate is now considering comprehensive six-year reauthorization legislation – the Safe, Accountable, Flexible and Efficient Transportation Equity Act of 2004 (SAFETEA) – for fiscal years 2004-2009.

The total spending authorized by the bill over the next six years is \$311 billion in contract authority (\$255 billion for highways and safety and \$56.5 billion for public transit), plus an additional \$6 billion in Highway Safety programs as reported by the Commerce Committee. This level comports to the figures agreed to by the Senate last spring during consideration of the FY 2004 Budget Resolution (S.Con.Res. 23); the surface-transportation funding amendment (vote no. 79) passed on a 79-21 vote. If enacted into law, this spending level would be a 42-percent nominal increase over TEA-21, which itself increased surface transportation spending by 40 percent over its predecessor. ¹

Unfortunately, the excise tax receipts used to finance most federal surface transportation projects have not kept pace with spending. Over TEA-21's first five years, outlays climbed by more than 50 percent, while excise tax receipts only grew by 13 percent. And the projections are worse: according to the Congressional Budget Office's current law baseline, over the next six years, transportation-dedicated excise tax receipts for highways and transit are expected to generate only about \$233 billion – about \$80 billion less than the contract authority provided in the Senate-reported SAFETEA bill (see Appendix A).

Although there are a few straightforward ways to increase user fee revenues – which the Finance Committee did incorporate into its reported package – these initiatives would only increase Highway Trust Fund (HTF) revenues by an estimated \$12.5 billion over the six-year authorization period.⁴ And even if the balance in the HTF is drawn down annually by an additional billion dollars or more (the HTF is expected to have a

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ie. cash flow demands on the HTF. Outlays were estimated at \$231 billion for highways and \$36 billion for transit.

¹ John W. Fischer, "Highway and Transit Program Reauthorization," *CRS Report for Congress RL31665*, December 11, 2002.

² Kim P. Cawley, "Status of the Highway Trust Fund," Congressional Budget Office, May 9, 2002.

³ "Actual and Forecast Excise Tax Receipts to the Highway Trust Fund," The Office of Tax Analysis,
Department of Treasury, May 9, 2002. The Senate Finance Committee funded the HTF at the outlay levels,
in each flow demands on the HTF. Outlaw wars estimated at \$221 billion for highways and \$26 billion for

⁴ The Senate Finance Committee approved the following initiatives: eliminating fuel tax fraud with stricter enforcement and clarifying the mobile machinery exemption on heavy vehicles (\$5 billion); eliminating the 2.5 cents per gallon transfer of gasohol tax to general revenues (\$5 billion); depositing revenue from gas guzzler tax in the HTF (\$500 million); and crediting the HTF with interest on its balances (\$2 billion). Congressional Budget Office estimates provided by the Senate Finance Committee, January 29, 2004.

year-end balance of \$9 billion),⁵ a significant funding gap remains that must be closed by pursuing one or more of the following options:

- Increase excise tax receipts either by increasing taxes on gasoline and other transportation funding sources, or by expanding the transportation excise tax base through the elimination of exemptions and special tax treatments (or some combination thereof);
- Use revenue raisers from non-transportation sources (i.e., general revenues) to finance the portion of the transportation authorization above excise tax receipts;
- Deficit-finance additional transportation spending; or
- Reduce the amount of contract authority authorized by the legislation to a level that could be financed by existing excise tax revenue with a few modifications.

The Senate Finance Committee's reported provisions followed a combination of options one and two. The Committee's proposals increase HTF receipts by eliminating exemptions and partially taxed motor fuels, charge the General Fund for the cost of these energy production incentives, and use revenue raisers to offset the deficit impact. Other options or combinations thereof may be considered on the Senate floor.

Option 1: Increase Excise Tax Receipts

To finance the funding shortfall, some Members have suggested raising the federal tax on gasoline and indexing it to inflation. According to the House Committee on Transportation and Infrastructure, a 5.4-cents-per-gallon tax increase on gasoline would bring the rate in line with inflationary increases that have occurred since 1993. This increase would raise about \$6 billion annually, which translates to approximately \$36 billion over the six-year authorization period.

The Administration and some Senators have expressed concern over this course of action because tax increases of any sort directly contradict Republicans' governing philosophy. According to the President's FY05 budget, "a gas tax increase would have a negative impact on consumers and the economy."

Increasing gasoline taxes also would be problematic because the revenue yield from gasoline taxes has fallen sharply. While the gasoline tax rate has increased by 360 percent between 1984 and 2001, gasoline tax revenues only have increased by 320 percent during the same period.⁹

This is in part attributable to increased fuel efficiency: Between 1970 and 2000, the number of vehicle-miles driven increased by 248 percent, while fuel use increased by

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⁵ Figure provided by Senate Budget Committee, January 30, 2004. The Senate Finance Committee assumed the HTF balance would be spent down to \$6.6 billion by the end of the six-year authorization. ⁶ Statement of Representative Thomas Petri, House Committee on Transportation and Infrastructure, May 30, 2003.

⁷ Based on numbers provided in Louis Alan Talley and Don C. Richards, "Gasoline Excise Tax – Historical Revenues," *CRS Report for Congress RS21521*, May 14, 2003.

⁸ The Budget of the United States Government, Fiscal Year 2005.

⁹ Figures derived from Talley and Richard, "Gasoline Excise Tax – Historical Revenues."

only 176 percent. ¹⁰ And, as passenger vehicles become more fuel efficient – as a result of either increased consumer demand or regulatory fiat – HTF revenues will decrease by an estimated \$3.5 billion for every one-mile-per-gallon efficiency increase. ¹¹

Another reason for the declining revenue yield has been the increased market penetration of alternative fuels, the most notable of which is gasohol (a blend of gasoline and corn-based ethanol), which is taxed at 13.2 cents per gallon, 2.5 cents per gallon of which is deposited in the General Fund. The federal tax on gasoline, in comparison, is 18.4 cents per gallon. While over \$20.6 billion in gasoline taxes were collected in 2001, this was 3 percent less than collected in 1999, partly due to increased use of gasohol. The second results are the increased use of gasohol.

The Treasury Department projects that gasohol use will increase steadily over the next 10 years as states phase out MTBE as an oxygenate additive and replace it with ethanol. As a result, the partial tax exception for gasohol will cost the Highway account an estimated \$13.72 billion over the next 10 years.¹⁴

In response, some Senators have suggested eliminating gasohol's special tax treatment. Many Senators vehemently oppose this initiative, contending that without the tax incentive, gasohol production may cease, which would depress corn prices and lead to an estimated increase in farm support payments to corn growers of \$2.1 billion. ¹⁵

Option 2: Use Revenues from Non-Transportation Sources

Instead of raising fuel excise taxes on motorists and truckers, other Senators have proposed using direct General Fund transfers to the HTF to close the funding gap. Some Senators have expressed opposition to this proposal because it violates the spirit of the "user benefit principle," which has guided surface transportation policy since the creation of the Highway Trust Fund in 1956. Under this framework, those who benefit from transportation expenditures pay the "user fees" necessary to finance them. ¹⁶ This policy is intended to benefit heavy users of the highway system by ensuring that the excise taxes they pay are not diverted to other uses. It also benefits those who use the highway system sparingly because the user fees constrain motorists' and truckers' demands for transportation expenditures.

Additionally, opponents of using General Fund revenue raisers express concern that such action would be too great a departure from TEA-21. What was most notable about that legislation, aside from being the largest public works bill in U.S. history, ¹⁷ was

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¹⁰ Larry King, Deputy Secretary, Pennsylvania Department of Transportation, in testimony before the House of Representatives Committee on Transportation and Infrastructure, July 16, 2002.

¹¹ King.

¹³ King.

¹⁴ JayEtta Z. Hecker, "Factors Affecting Highway Trust Fund Revenues," GAO-02-667T, May 9, 2002.

¹⁵ Brent D. Yacobucci and Jasper Womach, "Fuel Ethanol: Background and Public Policy Issues," *CRS Report for Congress RL30369*, January 14, 2004.

¹⁶ Kenneth Button, Jonathan Gifford, and John Petersen, "Public Works Policy and Outcomes in Japan and the USA," George Mason University School of Public Policy, October 2001.

¹⁷ Mark Murray, "Heavy Tolls Ahead," *National Journal*, Friday, May 16, 2003.

its clear and conspicuous affirmation of the user benefit principle. TEA-21 created two new budget categories for highway and mass transit spending and gave both programs special status in discretionary spending, similar to entitlements. TEA-21 also linked spending for highway programs directly to annual revenue collections for the HTF under a complex financing mechanism called "Revenue Aligned Budget Authority" (RABA). These two developments created a "firewall" around \$198 billion of the legislation's \$217.9 billion overall funding level and sought to ensure that any unexpected increases in excise-tax revenue would trigger automatic highway spending increases. ¹⁹

However, as the Department of Transportation (DOT) wrote in its summary of TEA-21, "a downward adjustment" of highway spending obligations could occur, "but this is improbable given the conservative receipt estimates used to guarantee spending levels." Instead, over the first several years of the authorization, RABA's upward adjustments provided a cumulative \$9.1 billion in additional highway spending. Then in 2001, HTF revenues fell well short of expectations. This required a negative RABA adjustment of \$8.6 billion for FY03, which was \$4.4 billion lower than the TEA-21 authorization level. ²¹

That negative RABA adjustment could have allowed the highway contract level for FY03 to fall to \$23.2 billion or to \$27.7 billion (as provided in TEA-21). Instead, Congress voted to retain the \$31.8 billion FY02 level, and passed it as part of the Consolidated Appropriations Resolution (P.L. 108-7), enacted at the beginning of the 108th Congress. In this instance, Congress did not have to turn to the General Fund to retain the spending level because there was a sufficient accumulated balance in the HTF.

Senate Finance Committee-Reported Package

The Senate Finance Committee opted to close the transportation-funding gap through a combination of options 1 and 2. As mentioned above, the Committee incorporated a few straightforward ways to increase HTF revenues by an estimated \$12.5 billion over the six-year authorization period with no deficit impact. These measures tightened fuel excise tax compliance, and transferred revenues from the General Fund that can legitimately be considered appropriate for the HTF.

The second set of proposals is designed to raise HTF receipts by charging the cost of fuel production incentives to the General Fund. There are a number of highway users who enjoy either an exemption from, or refund of, fuel excise taxes for reasons wholly unrelated to surface transportation policy. The HTF is charged for these exemptions or refunds, which are generally processed after the excise tax has been collected. The HTF bears this burden even though these users benefit from the federal highway system.

¹⁹ JayEtta Z. Hecker, "Overview of Highway Trust Fund Financing," GAO-02-45T, February 11, 2002.
 ²⁰ U.S. Department of Transportation, "Transportation Equity Act for the 21st Century: A Summary," January 1999.

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¹⁸ John W. Fischer, "The Transportation Equity Act for the 21st Century and the Federal Budget," *CRS Report for Congress* 98-749E, September 4, 1998.

January 1999.
²¹ Fischer, "Highway Finance: RABA's Double-Edged Sword." *CRS Report for Congress RS21164*, May 19, 2004.

For example, in lieu of a tax increase on gasohol, the Senate Finance Committee opted to implement an excise tax credit program where the HTF would receive an additional 5.2 cents per gallon of gasohol sold, but the additional tax would then be refunded to producers of alcohol and biodiesel fuel mixtures from General Fund outlays. As a result, the Joint Committee on Taxation's estimate of the revenue effects of this proposal is equal to its estimate of the proposal's outlay effects. ²³

The Senate Finance Committee proposals charged the cost of these energy production incentives to the General Fund, which created a deficit impact of approximately \$17 billion over the six-year authorization. ²⁴ The Finance Committee then offset the impact of these changes through revenue raisers previously developed and approved by the Finance Committee. ²⁵ The effect of these proposals is to: align HTF resources with surface transportation spending without a direct transfer of general revenues; and cap highway spending by the amount of revenues generated by the highway account of the HTF.

Opponents of this proposal argue that since the funds technically deposited in the HTF are never collected, or, more precisely, immediately rebated through General Fund outlays, it is disingenuous to suggest that these proposals truly close the gap between transportation excise tax revenue and surface transportation spending. In this way, opponents contend, the relationship between HTF revenues and outlays is reconciled in an accounting sense, but not in any substantive way.

Option 3: Deficit-Finance Additional Transportation Spending

Another option to increase federal transportation spending without increasing fuel excise taxes would be to deficit-finance any spending above what is provided by the HTF. Supporters of this proposal argue that any proposed changes in the tax code should be based on their merits and not assembled simply to plug a transportation-financing hole. Although the Administration and Treasury Department have unveiled several revenue-raising proposals in the 2005 Budget, they have not connected any of these proposals to the surface transportation shortfall.

Supporters of deficit financing also point to the fact that much of the mass transit budget is already financed in the regular appropriations process without any concern for matching spending levels to specific revenue raisers. Since passage of the Surface Transportation Assistance Act of 1982 (P.L. 97-424), the transit account of the HTF has

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²² This proposal is contained in the "Volumetric Ethanol Excise Tax Credit Act." See "Description of the Highway Reauthorization and Excise Tax Simplification Act," Senate Finance Committee, available at: http://finance.senate.gov/sitepages/leg/012904leghrts.pdf. The Finance Committee noted that all other major energy production incentives are charged to the General Fund.

²³ Estimated Revenue Effects of the Chairman's Modifications to the "Highway Reauthorization and Excise Tax Simplification Act of 2004," Joint Committee on Taxation.

²⁴ This figure is derived from totaling the deficit impact of the Senate Finance Committee's VEETC (\$9 billion) and IRC fuel refund mechanism (\$8 billion) proposals.

billion) and IRC fuel refund mechanism (\$8 billion) proposals.

These proposals consisted mainly of closing corporate tax loopholes and clarifying the economic substance doctrine.

received a portion of highway user fees (this figure reached 2.86 cents per gallon of gasoline, diesel, and gasohol in 1998, see Appendix A), although this user-fee diversion is not expected to cover transit's full appropriation. For example: in FY01, mass transit account receipts totaled \$4.6 billion in the HTF, but the Federal Transit Administration's FY01 appropriation was \$6.3 billion. ²⁶

Opponents of deficit-financing the transportation reauthorization, including the Chairman of the Senate Budget Committee, point to the Office of Management and Budget's (OMB) projected FY04 budget deficit of \$521 billion. ²⁷ To add to such a large deficit at the start of the legislative session, opponents contend, is not only fiscally imprudent, but also invites further deficit spending later in the year. Moreover, because transit spending is designed to serve two main purposes – to provide mobility for those who cannot drive and lessen highway traffic congestion by providing transportation alternatives – the revenues from the user fees are not expected to cover the program's entire cost, but only the amount which accounts for those commuters who otherwise would drive.

Option 4: Reduce the Amount of Contract Authority

Other Senators support reducing the size of the surface transportation legislation to a level that can be financed by existing transportation excise tax revenue and the transfers of funds that can legitimately be considered appropriate for the HTF. Not only is the Senate SAFETEA's proposed spending level 42-percent higher than TEA-21 in nominal terms, it represents a whopping 31.5-percent real increase in spending over **TEA-21**. This fundamental mismatch between desired transportation spending levels and user fee receipts is caused by imprudent spending in a time of budget deficits and a lack of concern for ways to reduce project costs, supporters of lower authorization levels argue.

This option also appears to be the preferred approach of the Bush Administration, whose FY05 Budget proposes \$256 billion for surface transportation over the next six years (see comparison chart on page 7). The Administration's FY05 budget request funds this amount by depositing the full amount of excise tax imposed on gasohol in the Highway Trust Fund; imposing additional registration requirements on the transfer of tax-exempt fuel; repealing the installment method for payment of heavy highway vehicle use tax; and prudent draw-downs on HTF balances (these same revenue-raisers were incorporated by the Finance Committee in its reported package – but because of the larger outlays required to fund the contract authority in the Senate bill, these provisions do not fully fund the bill).²⁹

²⁶ CRS RL31854, Transit Program Reauthorization.

²⁷ Office of Management and Budget, Budget Totals, Budget of the United States 2005, February 2, 2004. ²⁸ The inflation rate used for this calculation is the growth in the Bureau of Labor Statistics' Producer Price Index for "Contract work and other miscellaneous receipts" in the construction industry. Since 1998, this PPI index value has increased by an average annual rate of 1.7 percent and cumulatively increased by 8.52 percent between 1998 and the end of 2003.

²⁹ Office of Management and Budget, Budget Totals, Budget of the United States 2005, February 2, 2004.

Supporters of the \$311 billion level make two key points: the Senate voted overwhelmingly to support this level less than 12 months ago; and transportation spending needs require nothing less. Indeed, according to the testimony of Federal Highway Administration Administrator Mary Peters, it will cost nearly \$76 billion a year to maintain the nation's highways and bridges from 2001 to 2020, and \$107 billion a year over the same period to improve infrastructure to the point where it would keep pace with the growth of travel.³⁰ Since the federal government typically provides 50 percent of national highway spending, the federal government would have to contribute \$53.5 billion annually to meet this need.³¹

	Senate	Administration							
HIGHWAYS									
Contract									
Authority	255	212.4							
Outlays	231	192.4*							
	TRANSIT								
Contract									
Authority	56.5	43.6							
Outlays	36.6	28.2*							
TOTAL									
Contract									
Authority	311	256							
TOTAL									
Outlays	267.6	220.6							
*+:+-									

^{*-}estimate based on historic proportional relationship between necessary outlays to finance contract authority

Proponents of lower contract authority argue that the dollar value of transportation "needs" is very difficult to calculate, varies widely from state to state, and must be considered in the context of current budget deficits. Even if such figures accurately represent necessary infrastructure investment, the Senate vote to increase the surface transportation contract authority to \$311 billion occurred before the size of the expected FY04 budget deficit was known. Lawmakers must bear in mind new budget deficit estimates when deciding to increase spending beyond that which can be financed by surface-transportation-related excise tax receipts.

Conclusion

The difficult transportation financing choices forced upon Senators highlight a growing gap between user-fee revenues and proposed spending. This gap was largely unanticipated at the time TEA-21 was passed, yet it will require much attention as – if trends persist – it continues to grow in the years ahead.

³⁰ Mary Peters, Administrator, Federal Highway Administration, in testimony before the House of

Representatives Subcommittee on Transportation and Infrastructure, September 26, 2002.

31 GFOA Issue Brief: Surface Transportation Funding, Government Finance Officers' Association, January 2003.

APPENDIX A

Current Sources of Federal Surface Transportation Program Revenue

chart taken from FHWA Fact Sheet: figures derived from Office of Tax Analysis (OTA) Estimates

chart taken from FHV	VA Fact Sh	eet; figures	derived fro	om Office o	t Tax Analy	/SIS (OTA)	Estimates
		Distribution of Tax					
			Highway Trust Fund				
Fuel Type	Effective Date	cents per gallon	Highway Account	Mass Transit Account	Underground Storage Trust Fund	General Fund	Estimated Revenue FY04-FY09 (in billions)
Gasoline	10/1/1997	18.4	15.44	2.86	0.1	-	131.25
Diesel	10/1/1997	24.4	21.44	2.86	0.1	•	56.26
Gasohol (10% ethanol)	10/1/1997	13	6.94	2.86	0.1	2.5	
	1/1/2001	13.1	7.04	2.86	0.1	2.5	19.24
	1/1/2003	13.2	7.14	2.86	0.1	2.5	
	1/1/2005	13.3	7.24	2.86	0.1	2.5	
Special Fuels:	1/1/2003	10.0	7.27	2.00	0.1	2.0	
General Rate	10/1/1997	18.4	15.44	2.86	0.1	_	
Ocheral Rate	10/1/1007	10.1	10.11	2.00	0.1		
Liquefied	10/1/1997	13.6	11.47	2.13	-	-	l
petroleum gas							
Liquefied natural gas	10/1/1997	11.9	10.04	1.86	-	-	
M85 (from natural gas)	10/1/1997	9.25	7.72	1.43	0.1	-	
Compressed natural gas (cents per thousand cu. ft.)	10/1/1997	48.54	38.83	9.7	-	-	
Truck Related Taxes — All proceeds to Highway Account							
Tire Tax	0-40 pounds, no tax						
	Over 40 pounds - 70 pounds, 15¢ per pound in excess of 40						
	Over 70 pounds - 90 pounds, \$4.50 plus 30¢ per pound in excess of 70						
					d in excess		
Truck and Trailer Sales Tax	12 percent of retailer's sales price for tractors and trucks over 33,000 pounds GVW and trailers over 26,000 pounds GVW						
Heavy Vehicle Use	Annual tax						
Trucks 55,000 pounds and over GVW, \$100 plus \$22 for each 1,000 pounds (or fraction thereof) in excess of 55,000 pounds (maximum tax of \$550)							6.639
	,						
GRAND TOTAL							233.5